

# The CSA's February 2008 proposed changes to executive compensation disclosure in Canada

A foundation for improved accountability  
through better information

---

*Please note that this briefing is presented only as an initial overview of the CSA's most recent proposed changes; HCI will provide formal input to the CSA during the comment period.*

---

## Introduction

On February 22, 2008 the Canadian Securities Administrators (CSA) released for comment a proposed set of changes (the 2008 Proposal) to its original March 2007 proposal (the 2007 Proposal) to amend the requirements for executive and director compensation disclosure in the proxy circulars of Canadian public issuers. The 2008 Proposal reflects the significant feedback received after the publication of the 2007 Proposal. There is a 60-day period (ending April 22, 2008) during which issuers and other interested parties have an opportunity to provide comments and suggest improvements.

Since the publication of the first request for comments on the 2007 Proposal, the CSA also has had the opportunity to review the SEC's October 9, 2007 report of the principal themes emerging from the regulator's review of issuer compliance with the executive compensation disclosure rules it implemented in 2007. The CSA has taken advantage of the experience gained from the SEC's review, along with the feedback received on the 2007 Proposal, to make significant improvements to the 2007 Proposal. As a result, the 2008 Proposal will better serve the goal of improving investors' understanding of how executive compensation works in the companies they own and the link (or lack thereof) between executive pay and corporate performance.

### For more information:

The **Canadian Securities Administrators** is a forum for the 13 securities regulators (including the **Ontario Securities Commission**) of Canada's provinces and territories to coordinate and harmonize regulation of Canada's capital markets.

The CSA's proposed changes, commentary, and questions can be found on any of its members' websites. For example, the Ontario Securities Commission has posted the proposals at:

[Statement of Executive Compensation](#)

([http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Parrt5/csa\\_20080222\\_51-102\\_f6-rfc-repeal.pdf](http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Parrt5/csa_20080222_51-102_f6-rfc-repeal.pdf))

### Summary of changes to the 2007 Proposal:

- The value of equity awards included in the Summary Compensation Table (SCT) will reflect the grant date fair value rather than the accounting expense.
- The pension value included in the SCT will reflect compensatory value rather than change in actuarial value.
- The confusing distinction between "bonus" and "non-equity incentive plan" columns in the SCT has been replaced with "annual incentive plan" and "long-term incentive plan" columns.
- Prescribed disclosure of payments on certain triggering events has been limited to four scenarios: retirement, resignation, termination and change of control



This briefing will provide a summary of the changes made to the 2007 Proposal by the 2008 Proposal and not on the overall changes from the existing executive compensation disclosure regime. For a discussion of these larger changes, see our April 2, 2007 Briefing on the 2007 Proposal.

## **Proposed changes to 2007 Proposal - Highlights**

### **1. Equity-based Awards - grant date fair value rather than accounting expense**

Under the 2007 Proposal, equity-based awards had to be disclosed at the accounting expense value for that year (according to Section 3870 of the CICA Handbook) which could result in numbers bearing no relationship to the *intended* grant date fair value of the grants actually made during the year or even misleadingly low or negative numbers. Hugessen, along with other commentators, proposed that issuers be required to report intended grant date fair value at date of grant in the SCT, valued in accordance with accepted valuation methodologies.

The CSA has chosen to make this change in the 2008 Proposal in order to more accurately reflect what the board intended to award as compensation. Under the 2008 Proposal, the valuation may be based on the valuation methodologies set out in section 3870 of the Handbook or another reasonable methodology used. The CSA has added a requirement to disclose in a footnote to the table or in the accompanying narrative, if the grant date value is different from the accounting fair value, the amount of the difference and an explanation of the difference

The issuer must also disclose a description of the methodology used to calculate the grant date fair value, disclosure of the key assumptions and estimates used for each calculation and an explanation of why the company chose that methodology.

### **2. Pension Value - compensatory value rather than change in actuarial value.**

The 2007 Proposal required an issuer to disclose in the SCT the change in the actuarial present value of the accumulated benefit under all defined benefit and actuarial pension plans (including supplemental plans). Hugessen and other commentators believe that investors want the SCT to tally comprehensive annual compensation for each NEO excluding changes in pension liability attributable to changes in valuation assumptions that have nothing to do with the intended level of compensation. To address these concerns, the 2008 Proposal departs from the 2007 Proposal and proposes including only compensatory values in the pension column in the SCT.

Importantly, the 2008 Proposal would include in the SCT the compensatory values for defined contribution plans as well as defined benefit plans.

### **3. Bonus and non-equity incentive plan columns clarified**

Under the 2007 Proposal, the SCT would contain two columns for cash bonuses. The first column would be labeled “bonus” and include only discretionary payments not linked to pre-determined performance objectives and the second column would be labeled “non-equity incentive plans” and include awards that are linked to pre-determined performance objectives. The columns would not reflect whether the programs involved annual or multi-year performance measurement periods.

Hugessen and other commentators argued that this distinction could lead to potentially misleading or confusing disclosure, a position with which the CSA agreed. The 2008 Proposal splits non-equity incentive plan compensation into two columns based on the length of the performance period associated with the awards. The “annual incentive plans” column includes both discretionary awards and those linked to predetermined performance objectives that relate to a single financial year. The “Long-term incentive plans” column includes all non-equity incentive plan compensation related to a period longer than one year. However, the proposal continues to prescribe disclosure of payouts rather than grant date values which may be somewhat confusing.

### **4. Disclosure of Targets**

The 2008 Proposal continues to require that specific performance targets will need to be disclosed where such disclosure is necessary to understand the executive compensation decisions for the previous fiscal year. The new wording that would permit targets not to be disclosed if to do so “would seriously prejudice a company’s interests” instead of resulting in “competitive harm”, appears to confirm the requirement to disclose performance goals under most circumstances. However, the intent of the wording change does, in our view, require further clarification. While the CSA states that this disclosure would ordinarily only include past targets, they have specifically not excluded the possibility that forward looking targets may be necessary if the goal of understanding exec comp decisions is to be met in certain circumstances.

### **5. Performance graph – disclosure of metrics in addition to TSR**

The 2008 Proposal retains the requirement to include a performance graph in an issuer’s CD&A showing the company’s cumulative total shareholder return (TSR) compared to the total return of at least one broad equity market index, along with the requirement to discuss the trend shown in the graph in relation to the trend in the company’s executive compensation. However, in response to comments by Hugessen and others that TSR, while important, is not the only metric to assess the performance of an issuer, the 2008 Proposal clarifies that an issuer may also include other relevant performance measures in its CD&A. If the company believes that other relevant measures are more meaningful than the link with share price, the company may also explain why.

## **6. Retirement Plans – reconcile liability per existing best practice**

The 2008 Proposal departs from the 2007 Proposal aligning more closely with existing best practices in Canada. Five new columns provide a continuity schedule with respect to the accrued obligation to date. Both compensatory and non-compensatory values are included, in separate columns, under the 2008 Proposal. Importantly, the same information will now be required for defined contribution plans whereas the 2007 Proposal table covered only defined benefit plans.

## **7. Termination and change of control benefits – focus on four scenarios**

The 2007 Proposal required issuers to provide detailed disclosure of potential payments related to various termination scenarios. As proposed by Hugessen and others, the 2008 Proposal now stipulates a standard set of four different scenarios (down from six) where issuers are required to disclose payment or other benefits to be received: retirement, resignation, termination and change of control (regardless of whether employment is terminated). Significantly, companies are required to quantify, describe and explain only the *incremental* payments and benefits that would be provided in each circumstance. In addition companies must disclose why they structured the terms and payment provisions as they did.

## **8. Change of terminology – “significant” instead of “material”**

The words “significant” and “significantly” have replaced “material” and “materiality” throughout the 2008 Proposal, which helps to remove confusion with the use of those latter terms as found in provincial securities legislation and under GAAP.

## **Notable provisions that remain unchanged**

- Issuers must disclose companies included in benchmarking and selection criteria where such disclosure is necessary to satisfy the objective of executive compensation disclosure and, where relevant, explain how the peer group was formed and why certain companies were included in the group.
- Share ownership guidelines do not need to be disclosed
- No additional information on compensation consultants is required and the current disclosure will not be moved to the CD&A. Another CSA committee is planning to review NI58-101, which deals in part with disclosure of compensation consultants and where such disclosure should be made and Hugessen encourages that committee to consider the content and placement of that disclosure with a view to relocating it in the CD&A.

## Impacts and actions

### First steps for issuers:

- Calculate the dollar value of every compensation component (annual and termination scenarios)
- Draft the CD&A, including the rationale for both the design and the payout under each plan
- Identify any problems brought to light
- Revise policies and plans as required (e.g. a number of US issuers are reducing change of control plans)
- Submit comments to the CSA by April 22, 2008

For Canada's largest issuers, the 2008 Proposal will not require major changes since many provide executive compensation disclosure similar to that proposed by the CSA. For many others, the 2008 Proposal, as did the 2007 Proposal, will require significant changes.

A number of issuers may want to play an active role in what will probably be the last opportunity to have input into the new executive compensation disclosure regime by making submissions before the end of the CSA's 60-day comment process. For these companies, rewriting their most recent proxy to conform to the 2008 Proposal would be an excellent way to assess the impact of the proposed rules. It will provide issuers with the opportunity to reflect on their compensation philosophies and processes, and to ensure that they are based on best practices and are clear and understandable to investors. The new rules are scheduled to come into effect on December 31, 2008.

---

*For further information or to schedule a discussion about this topic, please call any one of the following consultants:*

*Ken Hugessen at 416-868-4422, [khugessen@hugessen.com](mailto:khugessen@hugessen.com)*

*Georges Soaré at 416-868-4416, [gsoare@hugessen.com](mailto:gsoare@hugessen.com)*

*Ian Mason at 416-868-4418, [imason@hugessen.com](mailto:imason@hugessen.com)*

*Catherine McCall at 416-868-4420, [cmccall@hugessen.com](mailto:cmccall@hugessen.com)*

*Damian Yu at 416-868-4423, [dyu@hugessen.com](mailto:dyu@hugessen.com)*

Hugessen Consulting (HCI) is an independent consulting firm dedicated to meeting the executive compensation consulting requirements of boards, compensation committees and senior management. The firm's mission is to be the leading provider of advice on executive compensation, performance measurement and assessment, and related governance to the compensation committees and top management of medium and large companies in Canada, the US, and the UK.

Visit [www.hugessen.com](http://www.hugessen.com)

© 2007 by Hugessen Consulting Inc. All rights reserved.